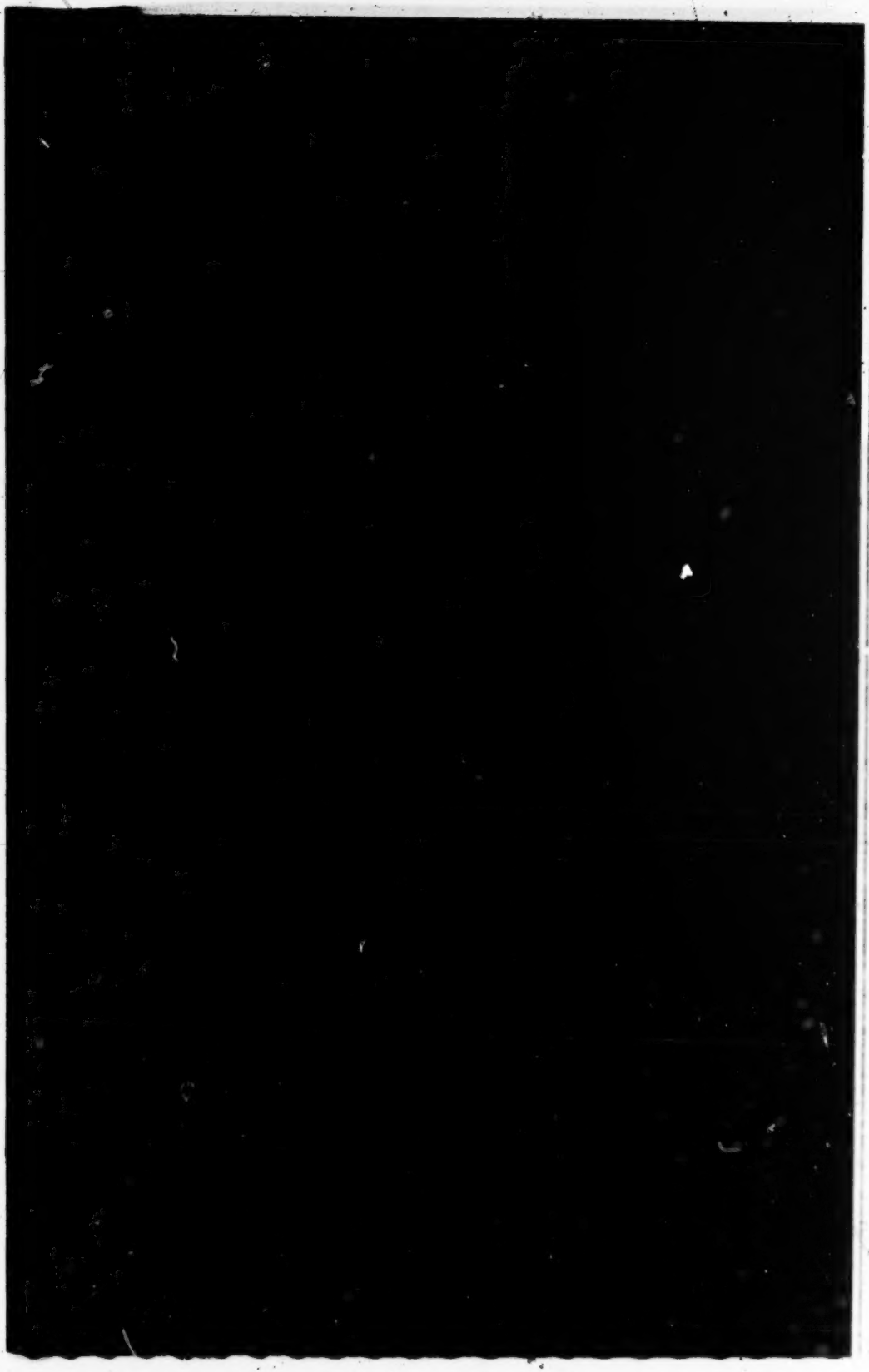

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 131

BESSIE P. DOUGLAS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON AND CHARLES J. ROBINSON, CO-EXECUTORS, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 47–57) is reported at 46 B. T. A. 943. The opinion of the Circuit Court of Appeals (R. 86–94) is reported at 134 F. 2d 762.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on April 7, 1943 (R. 94–96). The petition for writs of certiorari was filed July 1, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an amount equalling the total deductions taken by the taxpayers, as lessors, for depletion on advance royalties in the years when such royalties were received should be included in gross income in a later year when the mining lease was terminated without any production having occurred under the lease.

2. Whether (in the case of Bessie P. Douglas) the amount deducted as depletion in 1933, when a net loss was sustained, should be excluded from gross income in the year of the termination of the lease because no tax benefit was received from the deduction in 1933.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved are set forth in the Appendix, *infra*, pp. 10–13.

STATEMENT

The Board of Tax Appeals adopted as its findings of fact (R. 47–57) the stipulated facts (R. 39–47). The pertinent facts may be summarized as follows:

Prior to 1929 Bessie P. Douglas, Adeline R. Morse, Charles H. Robinson and Irene B. Robinson Cirkler owned an iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" mine. Bessie P. Douglas owned an undivided one-half interest in the mine and each of the others an undivided one-sixth interest therein. (R. 40.)

In 1929 the owners leased the mine for a term of thirty years commencing July 1, 1929. The lease provided that minimum royalties should be paid annually whether any ore was extracted during the year or not. Such royalties were to be applied on ore later mined and shipped. The lease also provided for its cancellation by the lessee and in 1937, pursuant to such provision, the lessee canceled the lease without having removed any ore from the mine during the existence of the lease. (R. 50.)

From the execution of the lease until its termination, the lessee paid the agreed advance royalties

to the lessors or their respective successors. The lessors or successors, in filing their income tax returns, which were prepared on the cash basis, reported in their gross incomes for the respective years the royalties received in such years and took deductions for depletion with respect to such royalties. The deductions thus taken were computed on the cost basis and were allowed by the Commissioner. (R. 50.) The amounts of royalties and depletion taken are set forth in tables at R. 41, 43, and 45.

In determining the deficiencies herein the Commissioner, under the provisions of Article 23 (m)-10 of Treasury Regulations 94, treated as gross income for 1937 the aggregate of the depletion deductions claimed by, and allowed to, the taxpayers for the years prior to and including 1936, with respect to the minimum royalties received by them from the lease on the Pettit mine. The amounts so included in gross income were: Estate of Charles H. Robinson, $9,829.14; Bessie P. Douglas, $53,299.03; Adeline R. Morse, $18,180.26; Irene B. Robinson Cirkler, $18,180.26. (R. 50.)

In the year 1933, the taxpayer Bessie P. Douglas had a net loss of $13,947.51. In that year she took a depletion deduction with respect to the advanced royalties in the amount of $4,958.05. (R. 41.)

The Board held (1) that the regulations on which the Commission relied are valid and (2) that all of the depletion deductions taken in prior

years were properly included by the Commissioner as taxable income except as to $4,958.05 in the case of Bessie P. Douglas (R. 51–57). As to that amount, the Board held she had received no tax benefit.

Accordingly, the Board found deficiencies in income tax for 1937 against Bessie P. Douglas in the amount of $26,977.56 (R. 57); against the estate of Charles H. Robinson in the amount of $1,532.38 (R. 58); and against Bernice B. Dalrymple, as transferee of the assets of Irene B. Robinson Cirkler, deceased, in the amount of $5,412.47 (R. 58–59).

The Circuit Court of Appeals affirmed the Board's decision on the first issue but reversed the Board on the second issue (involving only Mrs. Douglas) and held on that issue that she must include the sum of $4,958.05 in income for the taxable year.

ARGUMENT

1. Section 23 (m) of the Revenue Act of 1936 (Appendix, *infra*, p. 10), provides for a reasonable allowance for depletion under rules and regulations to be prescribed by the Commissioner. Article 23 (m)–10 of Regulations 94, promulgated thereunder (Appendix, *infra*, p. 12), provides that when a mining lease expires or is abandoned before the mineral which has been paid for in advance is extracted, the taxpayer shall adjust his capital account by restoring thereto the depletion

deductions made on account of royalties on mineral paid for but not removed and a corresponding amount must be returned as income for the year the lease is terminated. The decision of the court below, holding that the regulation is a reasonable and valid regulation, is in accord with previous decisions. *Sneed* v. *Commissioner*, 119 F. 2d 767 (C. C. A. 5th), rehearing denied, 121 F. 2d 725, certiorari denied *sub nom. Thompson* v. *Helvering*, 314 U. S. 686; *Lamont* v. *Commissioner*, 120 F. 2d 996 (C. C. A. 8th). See also *Crabb* v. *Commissioner*, 119 F. 2d 772 (C. C. A. 5th), remanded to the Board for a rehearing on a different ground, 121 F. 2d 1015. The validity of the regulation is reinforced by the fact that a like provision has appeared in all of the regulations relating to the income tax since 1919, and in each instance has been issued pursuant to a statutory provision similar to that referred to in Section 23 (m), *supra*. Cf. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 302.[1]

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[1] The regulation first appeared in Regulations 45, Article 215, and was issued pursuant to Section 214 (a) of the Revenue Act of 1918 and appeared thereafter in Regulations 62, Article 213, issued under Section 214 (a) of the Revenue Act of 1921; Regulations 65 and 69, Article 216, issued under Section 214 (a) of the Revenue Acts of 1924 and 1926; Regulations 74, Article 236, issued under Section 23 (l) of the Revenue Act of 1928; Regulations 77, Article 230, issued under Section 23 (l) of the Revenue Act of 1932; Regulations 86, 94 and 101, Article 23 (m)-10, issued under Section 23 (m) of the Revenue Acts of 1934, 1936 and 1938, and Regulations 103, Section 19.23 (m)-10, issued under Section 23 (m) of the Internal Revenue Code.

The decision of the court below is not inconsistent with *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, holding that the Revenue Acts have uniformly assessed income tax on the basis of annual returns showing the net result of the taxpayer's transactions during the year. In the earlier years when the minimum royalties were received, depletion was allowed in anticipation of production. *Murphy Oil Co.* v. *Burnet, supra;* Article 23 (m)-10 of Regulations 94. Until the lease was terminated, it could not be known that the ore paid for in advance would not be removed and it was reasonable to condition the allowance of the depletion in the earlier years on the restoration of the amounts to income if the lease should be terminated without the removal of the ore. This result is a consequence of, and not inconsistent with the annual structure of the income tax. Cf. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 352; *Doyle* v. *Commissioner,* 110 F. 2d 157 (C. C. A. 2d), certiorari denied, 311 U. S. 658; *Virginia Iron Coal & C. Co.* v. *Commissioner,* 99 F. 2d 919 (C. C. A. 4th), certiorari denied, 307 U. S. 630; *Commissioner* v. *Dallas Title & Guar. Co.,* 119 F. 2d 211 (C. C. A. 5th). Also compare *Helvering* v. *Braun,* 309 U. S. 461.

The taxpayer argues that the regulation is contrary to Section 23 (m) which prohibits an adjustment of the basis for depletion. The sentence relied upon, however, merely provides that where

the estimate of recoverable units is discovered to be erroneous as a result of operations or development work, the estimate of recoverable units, but not the basis, shall be adjusted. It has no application to a case where a lease is terminated and the right to depletion ceases.

2. Assuming that the first issue has been correctly decided, a second one is presented in the case of Mrs. Douglas as to whether the amount of the depletion deduction taken by her in 1933, when she sustained a net loss, should be included in income in the taxable year. In repudiating the tax benefit theory and deciding this issue against the taxpayer, the court below relied on its own decision in *Harwick* v. *Commissioner,* 133 F. 2d 732 (C. C. A. 8th), now pending here on certiorari granted June 14, 1943,[2] on *Helvering* v. *State-Planters Bank & Trust Co.,* 130 F. 2d 44 (C. C. A. 4th), and on *Helvering* v. *Virginian Hotel Corporation,* 132 F. 2d 909 (C. C. A. 4th), affirmed by this Court on June 7, 1943, No. 766, 1942 Term. However, the pendency of the *Harwick* case in this Court does not require the granting of certiorari herein, for the decision below is in accord with Treasury regulations of long standing that are not involved in the *Harwick* case.

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[2] The *Harwick* case and companion cases are presently identified in this Court as *Dobson* v. *Helvering*, Nos. 44-47, 1943 Term.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
LOUISE FOSTER,
Special Assistants to the Attorney General.

JULY 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (m)-10. *Depletion—Adjustments of accounts based on bonus* or advanced royalty. * * *

(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

* * * * *

ART. 23 (m)–11. *Depletion and depreciation accounts on books.*—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be recorded the cost or other basis provided by section 113 (a), as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments required by section 113 (b).

If the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it can not be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation computed in accordance with articles 23 (m)–2, 23 (m)–3, 23 (m)–4, or 23 (m)–5; or the amounts of the depletion and depreciation so computed shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the cost or other basis of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed, except such depletion deductions as may thereafter be allowable under section 114 (b) (2), (3), or (4) and articles 23 (m)–3, 23 (m)–4, or 23 (m)–5.

* * * * *

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